STANDARD & POOR'S
RATINGS SERVICES

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Summary:

Fairfield, California; General Obligation

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Rationale

Standard & Poor's Ratings Services revised its outlook to negative from stable on debt issued for Fairfield, Calif. In addition, Standard & Poor's affirmed its 'A' long-term rating on the city's pension obligation bonds (POBs). We base the negative outlook on the city's large historical and projected structural deficit absent the approval of a local sales tax measure.

The rating reflects our view of the city's:

- Revenue and assessed valuation (AV) declines in the past few years, due to the housing downturn;
- The city's structural deficit absent of a voter-approved sales tax measure; and
- Uncertainty around the city's projected and budgeted new property tax revenues from the dissolution of the redevelopment agency.

Offsetting credit factors, in our view, include the district's:

- Diverse tax base with rebounding sales tax revenues;
- Very strong wealth and good per capita income indicators supported by the city's employment access to the San Francisco Metropolitan Statistical Area,
- Management's demonstrated willingness to reduce expenditures to maintain strong-to-good reserves despite declining revenues in the previous four years; and
- Good financial management practices and policies that include long-term financial planning.

The bonds are secured by the city's obligation to make appropriations and its absolute and unconditional obligation to make debt payments on the bonds from any legally available funds.

Fairfield, with an estimated population of 104,172, is midway between San Francisco and Sacramento at the intersection of Interstates 80 and 680 and is the county seat for Solano County. The city's median household effective buying income is strong, in our opinion, at 124% of the national average. Its unemployment rate in May 2012 was 11%, which is higher than the state's rate of 10.4%. Major employers include Travis Air Force Base, as well as local government, medical centers, retailers, and food and beverage manufacturers.

After several years of growth and residential development, as with many California cities, Fairfield experienced an overall retrenchment in the housing market. The city's taxable AV, excluding the redevelopment incremental value, fell 15.7% between fiscal years 2008 and 2011. In fiscal year 2012, AV stabilized, increasing by a 1.4% to $9.6 billion, which is below the city's 2007 AV level. Nevertheless, market value per capita, an indicator of wealth, is still very strong in our opinion at $91,771.

In fiscal year 2013, the city's adopted budget includes an operating deficit of $2 million, or 3.3% of expenditures, despite a $1.5 million increase in sales tax revenues and $6.7 million in expenditure reductions. The expenditure reductions include a 10% reduction in salaries from furlough days for all employees except for sworn police officers and employees paying more toward health and pension costs. With the deficit, the city plans to end fiscal year 2013 an available fund balance of $4.6 million, which, at 7.6% of general fund expenditures, we consider good. We understand that the city has $5.8 million in its Intergovernmental Loan Fund (IGLF), excluding projected land sales, which it can use to support the general fund. Including the IGLF, the city will have an available fund balance of 17.4% of general fund expenditures.

The 2013 budget includes approximately $4.5 million in new property tax revenue from the dissolution of the city's redevelopment agency and $2 million in Assembly Bill (AB) X1 26 one-time redistribution of property taxes from redevelopment agency money. There is some uncertainty around these figures, given that there are no historical figures to rely on and the political and legal issues that surround redevelopment money. The new source of property tax revenue for the general fund is an estimate of property taxes that would have flowed to the former redevelopment agency, a portion of which will now be distributed to the city after accounting for debt service, administrative expenses, and pass-through payments. The city reports it received $1.2 million in the first property tax revenue distribution to taxing entities on June 1, 2012 after the dissolution of redevelopment agencies. Redevelopment agencies were dissolved in the state as of Feb. 1, 2012. The city is acting as successor agency to the redevelopment agency.

Prior to the dissolution of the city's redevelopment agency, the city relied on its Intergovernmental Loan Fund (IGLF) as a source of revenues. The IGLF was used to account for one-time sources, as well as interest earned and repayment on loans made to city funds or affiliated agencies, particularly the redevelopment agency. In fiscal years 2011 and 2012, the city transferred in $8.3 million and $7 million, respectively, into the general fund from the IGLF. The fiscal 2013 budget does not include a transfer from the IGLF. City management indicates that the money transferred into the general fund in fiscal 2011 and fiscal 2012 are not subject to reversal via AB X1 and AB 1484 because they were made prior to January 2011. The redevelopment agency historically transferred all net revenue -- after debt service, transfers to the state, administrative costs, and projects costs -- to the IGLF to repay previous advances from the general fund.

Outside of the loss of the money the city transferred into the general fund from the IGLF, the dissolution of the redevelopment agency is unlikely to have a significant effect on the financial operations because money in the redevelopment agency fund is adequate to cover the obligations of the successor agency. We understand the agency remitted $12 million back to the county on July 12, 2012, which was paid out of the redevelopment fund, for retroactive payment of surplus property tax distributions to the successor agency following the passage of AB 1484, passed on June 27, 2012. We understand that $7.4 million was transferred to the IGLF from the RDA after January 2011, $2.9 million of which was repaid in fiscal 2012. The city has indicated that it would use IGLF money to repay the remaining balance of $4.5 million, which the city has not been required to pay back thus far.

The city's fiscal year 2012 year-end estimates show an operating surplus of $1 million, representing 1.7% of general fund expenditures. Management attributes the surplus to a $1.8 million increase sales tax revenues, $7 million transfer in from the IGLF, and $7.1 million in expenditure reductions. With the surplus, the city estimates that it will end 2012 with an available fund balance of $6.6 million or 11.1% of expenditures, which we consider strong. For fiscal year 2011, the most recent audited year, the city finished the year with a $3.2 million operating deficit, inclusive of an $8.3 million transfer in from the IGLF and $7 million in expenditure reductions.

Looking forward, the city is projecting an average deficit of $7.8 million over the next three fiscal years, from 2014 through 2016. The city is hoping to eliminate the deficits by increasing revenues through a 1% sales tax measure. The city projects that the sales tax measure would generate anywhere between $12 and $13 million a year in additional revenues. The tax measure has been approved to be on the November ballot and would require a simple majority vote. Should the tax measure pass, the city's management will look to maintain the current level of service, address street maintenance issues, and increase available reserves. Should the tax measure fail, city management has proposed making staffing reductions to police and fire, close or severely limit the operating hours of community facilities, and further reduce street maintenance. Without the passage of the tax measure and absent expenditure reductions, the city projecting it will have a negative available general fund balance at the end of fiscal 2014. Given that the city has shown a willingness to reduce expenditures through staffing and salary reductions, we expect the city to make further expenditure reductions to prevent a negative fund balance.

Fairfield's management practices are considered "good" under Standard & Poor's financial management assessment (FMA) methodology. An FMA of good indicates that practices exist in most areas although not all might be formalized or regularly monitored by governance officials. The city maintains a general fund reserve policy that requires at least 5% of general fund expenditures in years when budget and staffing cuts are enacted and a goal of 15% of expenditures. The policy also requires the council or city manager take action to reduce appropriations as necessary to maintain reserves of at least 5%. The city annually prepares a comprehensive 10-year financial plan with its budget, which is tied to its 10-year capital improvement plan. A policy requires council to formally review the budget midyear, and the city approves its investment policy annually and prepares quarterly investment reports.

Fairfield's overall debt burden is moderate in our view, at $3,339 per capita and 3.6% of market value. Its debt service carrying charge is elevated in our view, at 17.2% of governmental expenditures less capital outlay in fiscal 2011, and amortization is below average with 48% of principal retired in 10 years. Management indicated that there are no plans to issue additional POBs or any other general fund-supported debt at this time.

The city made its annually required contribution to the California Public Employees Retirement System in fiscal 2011, which represented 5.3% of the city's total governmental expenditures, less capital outlay. The city's other postemployment benefits (OPEB) unfunded actuarial accrued liability totals $14.8 million, and the fiscal 2011 annual required contribution (ARC) was $810,000 of which the city paid $437,000. The combined pension and OPEB ARC represent 5.7% of total governmental expenditures, less capital outlay.

Outlook

The negative outlook reflects our assessment of the city's structurally unbalanced budget, with projected deficits in the next two fiscal years, which could deplete general fund reserves should the voters decide not to raise local sales taxes in the November election and without further budget adjustments. The outlook also reflects the uncertainty around projected new property tax money from the dissolution of the redevelopment agency. We could lower the ratings in the next year if the tax measure fails and the city does not address its structural deficits. We could revise the outlook to stable in the next year if the city maintains available general fund reserves we consider good. We do not expect to raise our rating in the next year.

Related Criteria And Research

USPF Criteria: Appropriation-Backed Obligations, June 13, 2007

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